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SUBJECT: BULGARIA LOCKS IN NEW DEAL WITH GAZPROM UNTIL 2030

Ref: SOFIA 1554

11. (SBU) SUMMARY: Bulgaria signed December 18 a deal with Russian gas giant Gazprom, guaranteeing Russian natural gas deliveries and transit until 2030. Insiders tell us the price of gas will gradually rise 40 percent by 2012 - largely due to the termination of the agreement to barter gas in lieu of cash transit fees. In return for Bulgaria's concession to pay higher gas prices, Russia will increase the amount of gas transited through Bulgaria to third countries. The Bulgarian government is expected to receive four times more in transit revenues over twenty years as a result of this increase. The lack of transparency surrounding the deal, however, raises suspicions that there are undisclosed side deals. END SUMMARY

12. (U) Following nearly year-long talks, the Bulgarian government has agreed with Gazprom on a new gas supply deal to replace the current agreement which expires in 2010. A memorandum to this effect was signed December 18 by Gazprom CEO Alexei Miller, Deputy Minister of Economy and Energy and Chairman of the BoD of Bulgargaz Valentin Ivanov, and the CEO of Bulgargaz Kiril Gegov. Minister of Economy and Energy Rumen Ovcharov, who led the talks with Gazprom and fiercely fought within the ruling coalition to get approval for the deal, hailed the agreement as favorable for Bulgaria's macro economic stability, saying Bulgaria has won "unprecedented concessions" from Gazprom. Ovcharov has admitted that details of the deal will not be fully disclosed at Gazprom's request; the Russian monopoly is currently in talks with several east European countries.

KEY PARAMETERS OF THE DEAL

13. (U) There will be a gradual rise in consumer gas prices over the next six years:

- * A 40 percent increase of consumer gas prices by 2012.
- * The first increase will occur on April 1, 2007 and will be less than 10 percent, followed by another smaller price increase in July.
- * The price increase will be highest in 2007. Additional increases will be evenly distributed over 2008, 2009, 2010, and in the last two years (2011 and 2012) the increases will be small.
- * Gas supplies will be paid only monetarily, i.e. there will be no more barter of transit fees in the form of gas.

14. (U) In 2007 Gazprom will begin to increase the amount of gas transiting through Bulgaria. The minimum guaranteed volume of natural gas flowing through Bulgaria until 2030 will be 17.8 Billion cubic meters per year. The transit quantity may increase by 5 Billion cubic meters per year after 2010. According to the Ministry of Economy and Energy, revenues from the increased transit of Russian gas will grow to USD 3.1 billion over twenty years from the current USD 800 million. Under the most optimistic forecasts about

transit, revenues could reach USD 5.2 billion. The transit tariff will increase every year indexed to the EU inflation rate.

¶5. (U) The government has further estimated that the new deal will cost Bulgargaz USD 500 million by end-2012 due to increased prices. Others put that number closer to USD 750 million. The government claims that losses from the reduction of the amount of transit gas through Bulgaria after 2010 could have cost state revenues between USD 2.3 billion and USD 4.4 billion if Russia chose to divert its gas through other routes. It appears that consumers will assume the burden of the price increase, while the government will retain the increased transit fees and not pass on the benefits to gas customers.

CURRENT CONTRACT

¶6. (U) Bulgaria currently buys Russian gas under two different contracts due to expire in 2010 - one for the direct supply of gas and one for gas in exchange for transit. Bulgaria presently receives 1.4 billion cubic meters of gas in barter for gas transit at USD 83 per 1,000 cubic meters. The remaining 1.7 billion cubic meters Bulgaria pays at the market price of USD 250-260 per 1,000 cubic meters. In this way, the country has managed to keep its current domestic prices relatively low, at about USD 170 per 1,000 cubic meters.

COMMENT:

¶7. (SBU) The long-term contract will mean a long-term dependency on Russian gas imports and Russian energy policies. Bulgaria's deal with Gazprom was signed in the absence of transparent public discussion, raising questions about who really profits from the arrangement. We have repeatedly pressed senior leaders over the past year that Bulgaria should avoid locking itself into long-term

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contracts and must continue to pursue alternative supply routes. While the government agrees to the need for energy - especially natural gas - diversity (Nabucco, Southern Corridor, Liquefied Natural Gas), this agreement takes some of the urgency out of those efforts.

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